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Directorate of
Intelligence

Mexico:
The Foreign Investment Issue

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A Research Paper

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September 1986

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Directorate of Intelligence

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A Research Paper

This paper was prepared by [redacted] the Office of Global Issues. Comments and queries are welcome and may be directed to the Chief, Development Issues Branch, OGI [redacted]

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Mexico:
The Foreign Investment Issue [redacted] 25X1

Summary

Information available as of 1 August 1986 was used in this report.

Mexico's longstanding aversion to foreign investment, in our judgment, is a major constraint on much-needed structural economic reform. President Miguel de la Madrid Hurtado has tried to be more receptive to foreign investment than his recent predecessors, but he has been unable to overcome several major barriers:

- *Philosophical Biases.* Many Mexicans believe foreign investment depletes nonrenewable resources and impinges on national sovereignty. As a result, initiatives that might attract more foreign investment are blocked by those—the established business community, government bureaucrats, labor leaders and leftist ideologues—who believe foreign investment is damaging to their interests.

- *Restrictive Legal Framework.* Foreign direct investment in Mexico is regulated by a comprehensive body of law, established during the 1970s, that discriminates against foreign investors by restricting equity positions and limiting protection of intellectual property.

- *Institutional Obstacles.* Once an investment proposal is approved, businessmen are confronted with numerous institutional impediments including subsidized government enterprises, a dearth of local credit, discouraging price controls, discriminatory incentives, accelerated taxation, import restrictions, and frustrating labor legislation. [redacted] 25X1

The Mexican investment climate has, in addition, deteriorated under de la Madrid. Two decrees, for example, implemented by the present administration have expanded regulatory requirements in the automotive and pharmaceutical sectors where foreign investment is highly concentrated. Moreover, the deterioration of Mexico's economy has further deterred potential investors and structural reform. [redacted] 25X1

Despite Mexico City's rhetoric to the contrary, foreign investors have long been discouraged by the unfriendly environment. Our estimates indicate that net foreign direct investment in Mexico averaged only 2.2 percent of gross fixed investment over the last decade and never accounted for more than 5 percent of the total. The Mexicans, instead, have shown a strong preference for borrowing, which was about 12 times greater than net foreign investment in the period 1976-85. [redacted] 25X1

Access to foreign credit from commercial banks has given the Mexican Government little incentive to make the reforms necessary to attract foreign investment. Should Mexico City take sufficient steps, foreign direct investment could make an important contribution in Mexico's long term economic development. In our view, the major contribution would not be financial, however, as even a doubling of last year's direct investment inflow would represent only a small fraction of the foreign borrowing expected this year. Instead, we believe the principal benefits of increased foreign investment arise from transfers of technology and the management practices introduced. Furthermore, Mexican enterprises would be able to form valuable customer and supplier links to foreign firms through their subsidiaries in Mexico. [redacted] 25X1

In order for Mexico to attract increased foreign direct investment, we believe Mexico City must first dismantle many barriers. At the margin, even small changes, like continuing to reduce the amount of redtape faced by potential foreign investors, would help. A major improvement in Mexico's foreign investment climate, however, will require structural reforms. Although domestic opposition would be strong, Mexico City could encourage foreign investors by phasing out price controls; liquidating nonstrategic, state-owned enterprises; improving intellectual property protection; and liberalizing restrictions on majority foreign ownership. [redacted] 25X1

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Mexico: The Foreign Investment Issue

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Mexico's Philosophy Toward Foreign Investment

The Mexican Government remains reluctant to grant concessions to foreign investors. According to official reports, this aversion is the outgrowth of what Mexico City views as centuries of unequitable relations with foreign states and investors. In particular, many Mexicans believe that foreign investment has historically resulted in the exploitation and exportation of nonrenewable resources and the excessive outflow of profit, with inadequate compensation through technology transfer and training for Mexicans. Furthermore, many Mexican businessmen believe profits are higher in an economy isolated from foreign competition. These attitudes have led Mexico City to implement restrictions and policies that discourage foreign investors.

Framework of Control. During the 1970s, a comprehensive body of law was implemented that established the ground rules for foreign investment in Mexico. Three laws initially enacted under the Echeverria administration remain at the heart of the Mexican system for regulating and controlling direct foreign investment:

- *The 1973 Foreign Investment Law* aimed to codify previously existing laws, policies, and regulations governing foreign investment. It requires that all foreign investment in Mexico be registered. It established the Foreign Investment Commission (FIC) to approve or disapprove contracts regarding the transfer of technology (for example, royalties, patents, trademarks, and know-how). The FIC rules on all plans for expansion, relocation, or new product lines by existing firms. This law reserves certain activities exclusively for Mexicans (appendix A gives additional details).

- *The Transfer of Technology Law* imposes standards and prior registration requirements for patents, trademarks, technology, and managerial services. It created the National Registry for the Transfer of Technology, which carefully scrutinizes contracts based on a number of criteria, including costs and local availability of technology. This law seeks to reduce Mexico's dependence on foreign technology and provide state support to Mexican purchasers in negotiations with foreign companies (appendix B gives additional details).

- *The Law on Inventions and Trademarks* may undergo revision. A decree has been proposed that could marginally improve intellectual property rights, although the current proposal still prohibits certain products such as pharmaceuticals, pesticides, and herbicides from being patented in Mexico. Neither product nor process are recognized as patentable in the case of pharmaceuticals. Patents are good for 10 years and are not renewable. If a patent is not exploited in the first three years, the government can reassign its rights to another company. A certificate of invention can be obtained in some cases where a patent is refused. A certificate has the same rights as a patent except for exclusive exploitation. The law also requires that all products fabricated in Mexico be labeled with a distinctive Mexican trademark, which must be at least equally linked when used in conjunction with a foreign trademark. This last provision produced so much controversy that it has yet to be implemented (appendix C gives additional details). 25X1

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While the Technology Transfer Law and the Law on Inventions and Trademarks have deterred foreign investors by limiting intellectual property rights, the most restrictive of the three laws is the one that established the FIC in 1973. The FIC is composed of seven Cabinet-level secretaries who screen all applications for potential investment in line with 17 criteria contained in Article 13 of the law. These criteria attempt to ensure that the proposed investment will: not displace national companies that are operating satisfactorily or be directed into areas adequately covered by national companies; have a positive effect on the balance of payments, particularly by expanding exports; increase local employment opportunities; incorporate local inputs into its products; and offer technological assistance to the country. [redacted]

Technically, permission for foreign investment is to be issued by the Cabinet-level agency that would have jurisdiction over the company applying. In practice, decisions are left to the FIC, which analyzes proposals on a case-by-case basis, according to official reports. Prior to the FIC's establishment under the 1973 law, foreign investors were free to begin their negotiations at 100-percent ownership; subsequently, investors have usually started from a 49-percent equity position. In addition, acquisition of more than 25 percent of capital or 49 percent of fixed assets in an existing Mexican company requires written FIC authorization under the law. [redacted]

Present Attitudes. Mexico under President Miguel de la Madrid has attempted to be more receptive to foreign investment than have recent administrations, but the US Embassy reports de la Madrid believes he cannot change the rules for foreign investment and that, if he tried, his administration would become "illegitimate." [redacted] de la Madrid and other prominent Mexicans who generally favor foreign investment, such as former Finance Minister Silva Herzog and Bank of Mexico Director Mancera, are from Mexico's technical elite and not well established within the party structure. These bureaucrats have held few elected positions and, as a result, have had fewer opportunities to become ingrained in the Institutional Revolutionary Party's (PRI) patronage system. [redacted]

The PRI dominates Mexican political life, and the party line toward foreign investment is much harsher than de la Madrid's. The party line was expressed at the party's 12th national assembly in 1984 by PRI President Adolfo Lugo Verduzco, who stated that foreign investment, far from strengthening the economy, constitutes a permanent drain on foreign exchange. Furthermore, Lugo said that other nations intervene in the Mexican economy through direct foreign investment, and therefore, one of the PRI's main economic objectives is to fight for its regulation and restriction. [redacted]

The financial crisis has intensified these divisions in Mexican attitudes toward foreign investment, especially since credit is increasingly difficult to obtain. Press reports indicate that a relatively small group of progressive bureaucrats and businessmen are working toward opening the economy by underscoring the need for inflows of foreign capital and technology to restart the economy. At the same time, the status quo has broad popular support. [redacted] resistance to foreign investment comes from highly protected industrialists who do not want to compete with multinational corporations (MNCs), from labor leaders who prefer to negotiate with Mexican businessmen, and from the political left, which blames foreign capital for many of Mexico's social problems. [redacted]

Flexible Interpretation of the 1973 Law. De la Madrid's administration has taken a number of actions in an attempt to attract more foreign investment. In February 1984, the FIC published a press release citing selected high-priority industries with the possibility of 100-percent foreign ownership (appendix D lists these industries). In August 1984, the government published another set of changes designed to speed up the processing of foreign investment applications and to remove some of the administrative requirements placed on foreign investors. The Under Secretary for Foreign Investment, Adolfo Hegewisch, is generally credited with having pushed through these new guidelines. The government claims the guidelines represent a concrete example of how it plans to flexibly apply existing restrictions on foreign investment. [redacted]

[redacted] according to the US Embassy, Secretary of Commerce and Industrial Development, Hector Hernandez, told representatives from nine Mexican political parties in March 1986 that Mexico will not modify its existing laws on foreign investment and will not indiscriminately accept foreign investment. [redacted]

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De la Madrid Decrees Sectorial Regulations

Moves to liberally interpret the 1973 law run counter to the tight controls that the de la Madrid administration has placed on foreign investment in key industries. It introduced an automotive decree in September 1983 and a pharmaceutical decree in February 1984, which greatly increase government regulation over sectors where foreign investment has been highly concentrated. The Under Secretary for Industrial Planning, de Maria y Campos, is generally credited with having pushed the automotive and pharmaceutical decrees through the bureaucracy. The two decrees are similar to the personal computer decree implemented under the Lopez Portillo administration in 1981. [redacted]

The Personal Computer Decree. This decree limits foreign ownership in personal computer firms to 49 percent. The decree requires that the use of locally made parts increase from at least 35 to 50 percent in the first four years of operation. Manufacturers must export 25 percent of the total value of imports in the first year of operation and 70 percent of imports in the fourth year. A minimum expenditure is required for personal computer research and development in Mexico. The decree requires that a price ceiling be set not higher than 50 percent above the US price for comparable equipment produced in Mexico. [redacted]

About 30 companies are approved to assemble personal computers in Mexico. Most are small and extremely undercapitalized Mexican operations with few employees, using what press reports call screwdriver technology merely to assemble imported components. In 1984, Apple Computer Inc. and Hewlett-Packard entered the Mexican market in compliance with the decree. According to press reports, the Mexican Government had offered Apple 100-percent ownership, but Apple declined. With a joint venture, Apple sought to share risks and gain an edge in selling to state-run companies because Mexico gives preference to domestic companies over wholly owned foreign subsidiaries. [redacted]

Despite protests from existing Mexican producers, including Apple de Mexico and Hewlett-Packard, the FIC announced in July 1985 that it had approved a revised proposal by International Business Machines (IBM) for a wholly foreign-owned personal computer plant in the El Salto industrial zone near Guadalajara. IBM claimed special treatment was justified because of the scale of its proposed manufacturing plant and its projected export earnings. The FIC disagreed until IBM presented some dramatic concessions in its revised proposal, including:

- An increase in capital investment from less than $7 million to more than $90 million over the next five years.
- A change in estimated local content from a maximum of 50 percent to 70 percent within three years.
- A promise that the technology gap between what is produced in Mexico and abroad by IBM would be no more than six months.
- A concession that the price differential for the Mexican products would be no more than 15 percent above comparable US goods. [redacted]

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The Automotive Decree. This was designed to improve the efficiency of the industry, promote research and development, generate employment, standardize components, and help strengthen Mexico's balance of payments. The decree reduced the number of car lines and models each assembler can produce; however, additional car lines can be earned through the export of components and vehicles. The average local-content requirement for each assembler increases to 60 percent for cars and 70 percent for light trucks by the 1987 model year. Even higher levels of domestic content are required for other classes of motor vehicles. Assemblers must balance foreign exchange transactions on a model year basis, and no more than 20 percent of foreign exchange earnings may be generated by in-bond industries. The decree reserves the medium-sized truck market for majority-Mexican-owned companies and provides for the continuance of price controls. [redacted]

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This last provision has effectively frozen Chrysler Corporation—Mexico's largest medium-sized truck producer—out of the domestic market. Although Chrysler attempted to comply with the decree by linking up with a Mexican partner, the government rejected the proposed joint venture. According to

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press accounts, Chrysler's proposal was received after the Mexican Government had approved joint ventures involving General Motors (GM) and Daimler-Benz. Government planners announced that two truck builders were preferable to three because fewer firms would allow the industry to achieve greater economies of scale.

In a related example, US Embassy reporting indicates Ford Motor Company was so upset by certain sections of the automotive decree that it threatened to postpone indefinitely construction of its new $500 million assembly plant in Hermosillo unless the government revised them. Since the Hermosillo project is the largest foreign investment announced since de la Madrid took office, a postponement would have been a real blow to Mexico's already fragile investment climate. While the FIC gave Ford's plan preliminary approval in 1984, company officers claim that they were not granted 100-percent ownership because of any flexibility in the 1973 Law's application. Ford officials stated the plant simply would not have been built if the Mexican Government had limited their ownership rights to 49 percent.

The Pharmaceutical Decree. This was announced in February 1984 but was not effective until April 1985, when amended regulations were published. The decree seeks to increase the participation of Mexican-owned firms in this sector and to conserve foreign exchange by reducing Mexico's dependence on imported pharmaceuticals. The decree institutes requirements for local content, export performance, and domestic research and development. In addition, the regulations require retail generic sales, uniform labeling and packaging, import substitution of active ingredients, and price equalization of equivalent drugs. It also calls for an expanded role of the government in the licensing, production planning, sourcing, pricing, and marketing of retail drugs.

The decree was given a hostile reception from 16 drug companies that sought injunctions against the decree in Mexican courts. Eventually, a subsidiary of Upjohn—a US-based multinational corporation—won a ruling in the courts that declared the decree unconstitutional. Other US-based pharmaceutical manufacturers enlisted the backing of the US Government, which linked the issue to the signing of a bilateral trade agreement benefiting Mexican exporters. Under this combined assault, Mexico decided to soften the impact of these strictures. The April 1985 version of the decree guarantees that firms developing new medicines will retain exclusive marketing and production rights and that newly developed products will be exempt from generic labeling requirements for 10 years as opposed to three years as originally stipulated. Secretary Hernandez insisted that the revisions in no way affected the essence of the original decree.

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All three decrees focus on areas where foreign investors are major players. In the computer arena, IBM will immediately dominate the field with projected output 10 times greater than its nearest competitor. Mexico's five largest automotive producers—GM, Chrysler, Ford, Volkswagen, and Nissan—are all foreign owned. While only 75 of the approximately 310 pharmaceutical laboratories in Mexico are foreign owned, they account for an estimated 75 percent of pharmaceutical sales in Mexico.

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Reports have been circulating for some time that the Mexican Government is preparing *new sectoral decrees* for the electronics and food-processing industry. If implemented, these decrees almost certainly would impinge on the operations of large foreign investments made by General Electric, Westinghouse, International Telephone & Telegraph, and Ericsson in the electronics industry, and on Nestle, General Foods, Anderson Clayton, and Carnation in the food-processing industry.

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Institutionalized Stumblingblocks

Beyond the laws and decrees that specifically discriminate against foreign investors, several other major impediments affect all private-sector investment.

These include subsidized government enterprises, the credit crisis, price controls, discriminatory incentives, accelerated taxation, import restrictions, and frustrating labor legislation.

The Pervasive State. A major problem facing potential foreign investors is the presence of state-supported competition in almost every industry. According to the Secretariat for Budget and Planning, the state's share of GDP was about 25 percent in 1983. The public's share of accumulated gross fixed investment, however, has been estimated to be over 50 percent in some press reports.

According to US Embassy reporting, the Mexican Government owned 820 companies at the end of 1985. The state has virtual or absolute monopolies in banking, petroleum and other hydrocarbons, basic petrochemicals, radioactive materials and nuclear energy, electricity, certain mining areas, railroads, and telegraph and wireless communications. The state also operates companies that produce a wide array of products, including food, steel, machinery, automobiles, chemicals, appliances, railroad cars, and cigarette tobacco. The number of state-owned firms has grown substantially in recent years because Nafinsa—a government-owned development bank—or other government organizations have taken over ailing private companies to save jobs.

Competition from state-owned enterprises can be intense and often unfair because of heavy subsidies. For example, the 10 largest state-owned companies, excluding Pemex, received 51 percent of their total revenues from federal transfers and external borrowing in 1985, according to US Embassy reports. The Embassy further indicated that Mexico planned to transfer 13 percent of the total proposed budget to state-owned companies in 1986.

Although the Mexican Government announced another program to reduce the number of state-owned enterprises in June 1986, several factors diminish the likelihood of its success. According to US Embassy reporting, the companies provide government officials with opportunities to siphon off money, to provide sinecures for friends and cronies, and to gain patronage through public employment, which is estimated to be 750,000. Press reports indicate many state-owned companies are industrial derelicts that would be unattractive to private investors, even if the government were making a serious attempt to sell them. In May 1986, Mexico City announced the closing of a large state-run steel mill in Monterrey, which was estimated directly and indirectly to have resulted in the loss of 30,000 jobs. Some Mexicans assessed the closure as a token act for the benefit of Mexico's international creditors, and others believe the increase in unemployment resulting from additional closures is politically unacceptable, according to US Embassy reporting.

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The Credit Crisis. The growing difficulty in obtaining local financing has further deterred potential investors. To finance current deficits and, more important, to service existing debt, the government has increasingly monopolized credit. Because banks are nationalized, the government can easily restrict private-sector access to credit by changing the loan portfolio requirements of the banks.

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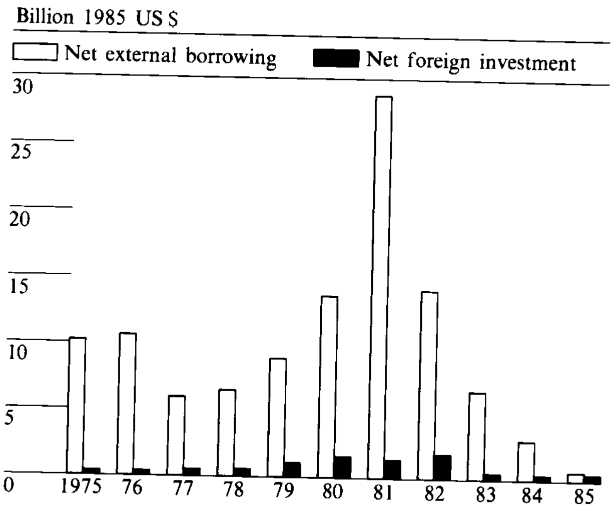
Defusing Mexico's Debt Crisis With Foreign Investment



We believe foreign direct investment is largely complementary to bank lending and should not be seen as a substitute for it. In our opinion, the decline in foreign direct investment is, in many ways, related to Mexico's debt servicing problems. For example, the Mexican Government has implemented price controls, restricted imports, accelerated taxation, and monopolized access to domestic credit in response to its current debt problems. All of these measures have also acted to discourage potential foreign investors. [redacted]

Our analysis indicates a significant rise in foreign investment requires that there first be an improvement in the debt situation and in growth prospects for Mexico. Although we believe a substantial increase in foreign investment would contribute to Mexico's structural adjustment, development, and capacity to repay debt over the long run, it seems equally clear that foreign direct investment itself cannot solve the debt crisis. Even if Mexico were now able to attract as much foreign investment as it did in 1982—its peak year—the inflow would represent less than 25 percent of the outflow in interest due on the external debt in 1986. [redacted]

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Exacerbating an already difficult credit situation was the announcement in March 1986 by Pemex and several other state-owned industries of a temporary suspension in payments to their suppliers. Pemex is the largest consumer of goods and services in Mexico, and its decision to delay payments is expected to impact over 3,500 companies. There is speculation that many small- and medium-sized companies might be forced into bankruptcy. [redacted] 25X1

Additional credit problems stem from recent changes in Mexican banking regulations reducing the amount of foreign exchange individual banks are allowed to retain, which is aggravating the difficulties of conducting international business transactions. Many MNCs are reluctant to increase their foreign exchange exposure by borrowing outside Mexico. Press reports state most managers believe that, by sticking to local borrowing and paying dollar liabilities as soon as possible, they are doing about as much as they can to limit foreign exchange losses if there is an acceleration in the peso's rate of devaluation. [redacted] 25X1

Discouraging Price Controls. Price controls have undermined market forces and limited profitable investment opportunities on a broad range of goods. A presidential decree in December 1982 revamped the price control system and institutionalized the three-tiered price control regime in use today. The levels are as follows: products for which prices are frozen, products for which companies may petition for price hikes, and products subject to price registration (appendix E gives a detailed breakdown of each group). The Secretariat of Commerce and Industrial Development *(Secofi)* takes a tough stance against violators. Some 6,000 wholesale and retail outlets were temporarily closed in 1984; fines totaling 1.1 billion pesos were levied; and, for the first time, wholesalers who intentionally kept basic foodstuffs from the market were imprisoned. [redacted] 25X1

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Producers reached an agreement with the Secofi in early January 1986 that will permit goods formerly requiring petitioned increases to rise by 80 percent of the previous month's inflation rate, according to US

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Embassy reporting. Any increase above the 80-percent level will require a justification and an examination of the company's accounts. Press reports, however, indicate that firms operating in socially sensitive areas, such as basic foods and pharmaceuticals, will continue to be hard hit by rigid price controls.

Price controls discourage production and investment in almost every industry. In the automobile industry, GM reports that its suppliers are allowed to raise prices at the inflation rate, whereas the government restricts GM's increases to less than the inflation rate. In the food processing industry, the US Embassy reports that in response to price controls—the controlled price for a liter of milk was 28 cents while the free market price was 74 cents at the end of 1985—milk producers in the State of Jalisco have ceased production and have begun to sell their livestock for meat. A spokesman for the pharmaceutical industry claims that from December 1984 to December 1985 the government authorized a 44- to 52-percent price rise, yet operating costs jumped 82 percent. In many cases, companies suspended production of unprofitable items until price relief was granted.

Discriminatory Incentives. Where special incentives put foreign-owned operations at a competitive disadvantage with Mexican firms, they discourage foreign investment. While a few majority-foreign-owned firms have been able to negotiate for some incentives, special incentives are generally reserved for majority-Mexican-owned companies. The government offers a broad range of generous incentives that include tax credits, preferential financing, and import duty exemptions.

The Mexican Government granted about $143 million worth of tax credits *(Ceprofi)* to Mexican firms in 1984. The value of Ceprofi ranges from 10 to 30 percent of federal corporate taxes, depending on the location of the investment, the type of industry, the number of jobs created, the purchase of equipment and machinery made in Mexico, and the size of the company—with small companies being favored. Ceprofi are valid for five years and may be used for payment of most federal taxes.

The government also offers qualified Mexican companies reduced income tax rates in mining, agriculture, fishing, construction, and book publishing. State-owned banks provide funds to:

- Companies in priority development areas and industries to capitalize small- and medium-sized companies by purchasing shares of stock.
- Subsidize loans for export and preexport.
- Subsidize Mexican manufacturers whose products replace imports.
- Export industries at subsidized interest rates for equipment purchases.

Companies establishing or expanding operations in certain priority zones of the country can qualify for subsidized petroleum products, natural gas, or electricity.

Accelerated Taxation. Much to the dismay of potential investors, the Mexican Government is seeking to generate more revenue to finance its debts by increasing the taxes paid by private business. President de la Madrid's administration proposed a new tax package in April 1986 that would mean greatly accelerated tax payments, selective rate hikes, and elimination of some incentives. In particular:

- Advance income tax payments would occur monthly instead of every four months, which is an important change in a high-inflation economy.

- The deadline for paying value-added taxes would be moved up from the 20th to the 10th of the month following a transaction, penalizing those who sell on credit, since the tax is charged from the time of billing.

- The schedules for other tax payments would be stepped up as well.

- The maximum fine for late tax payment would increase from 300 to 500 percent of the total amount due.

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- Benefits derived from tax credits would be added to taxable income, cutting the value of the credit by more than half and increasing obligatory profit-sharing contributions paid by employers.

- Mandatory social security taxes paid by companies would be raised from 9.4 to 11 percent, while contributions paid by the government would be reduced by the same spread.

The proposed bill would also repeal Article 8 of the Mexican Foreign Trade Bank's regulations—allowing 5-percent import financing for capital goods—in an effort to stimulate greater local production. [redacted]

The tax laws already have been changed once this year. Changes enacted in January severely restrict the opportunities of small businesses that had been referred to as minor taxpayers. Another part of this revision increases tax revenues by requiring businesses to adjust all income to show the effects of inflation and exchange rates. [redacted]

[redacted] these changes have caused large numbers of former taxpayers to take the risk of dropping off the taxpaying rolls. Tax specialists estimate that 70 percent of the taxpaying population evades taxes to some degree. [redacted] [redacted] income tax payments, both corporate and personal, make up about one-fourth of total government income, and 90 percent of the income tax contributions are paid by 10 percent of the contributors, primarily MNCs. [redacted]

Restricted Imports. Import barriers force many Mexican producers to use overpriced and low-quality domestic inputs. This discourages foreign investments that require low-cost inputs to compete in the international marketplace. A major tenet of Mexico's economic strategy has been import substitution, and, as a result, Mexico has instituted high tariffs. In many cases, Mexico calculates tariff duties based on "official value" rather than customs value. According to the US Embassy, the "official value" is not related to the product's actual value; rather it reflects the Mexican Government's determination of what constitutes a fair value and appropriate production cost. [redacted]

In July 1985 the Mexican Government began liberalizing its import regime, removing most licensing requirements, and reducing tariffs on a wide array of products. Despite this liberalization, Mexico continues to control about 900 items through permit requirements, and very high tariffs generally have replaced the import permits on other goods. Where import licensing remains, applications are reviewed on a case-by-case basis and permits are not granted if acceptable substitutes are manufactured locally or if the reviewing officials do not deem the import acceptable. Furthermore, Mexican officials have suggested that import restrictions in the agricultural and certain industrial sectors—steel, automotive, petrochemical—might need to be retained permanently. [redacted]

Recent measures to liberalize import restrictions have been undertaken by Mexico largely to accelerate its admission as a contracting member to the GATT, which was effective in August 1986. [redacted] [redacted] one of Mexico's main objectives in joining the GATT is to gain most-favored-nation (MFN) trading concessions from the other participant nations. While many Mexican exporters will immediately benefit from MFN status, Mexico City will have until 1994 to reach full compliance with GATT regulations. Because most companies entered Mexico under a protectionist system focused on developing domestic industries without regard to international competitiveness, we expect Mexican and foreign-owned companies will petition the Mexican Government to delay implementation throughout the eight-year transition period. [redacted]

Frustrating Labor Legislation. In our judgment, Mexican labor laws also discourage foreign investors. Large severance benefits have saddled many firms with incompetent and superfluous workers, making foreign investment in Mexico less profitable. The Federal Labor Act of 1970 stipulates that, unless they are dismissed for incompetence or other justifiable causes, laid-off employees are entitled to three months' pay and 20 days' additional pay for each year of service. Workers employed over 12 years are eligible for even greater compensation. If an employee

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decides to appeal a dismissal, the employee must be paid from the last day of work until the Mexican courts reach a final decision.

The Labor Act establishes several other onerous regulations, which annoy private-sector investors. The Act generally requires that 90 percent of a firm's skilled and unskilled workers be Mexican nationals, that companies with more than 100 employees maintain a fully equipped infirmary, and that firms with more than 300 employees establish hospital facilities. Although Mexican labor costs are low by international standards, additional payments cut into profit margins:

- Employers are obliged to pay their employees 125 percent of normal pay during vacation periods.
- A Christmas bonus of 15 days' pay is also obligatory and must be paid before 20 December.
- Companies must also contribute to employee profit sharing, the social security system, and the national workers' housing institute.

Despite these considerations, most firms still find Mexican labor plentiful and relatively cheap. The serious shortage of skilled labor and management personnel is of greater concern to most companies than is the approximately 60-percent increase in base payrolls caused by fringe benefits. Employee absenteeism and turnover are also serious problems, which disrupt production and raise training costs.

Ways To Gain Majority Control

Although a combination of foreign investment laws, sectoral decrees, and institutionalized stumbling-blocks create a foreign investment climate that is less than hospitable, some intrepid investors continue to submit new proposals for Mexican operations. Few proposals gain immediate approval from the FIC for both 100-percent foreign ownership and access to the domestic market. Foreign businessmen, however, who are determined to maintain control over their investments are finding ways. Beyond conventional approval by the FIC, three other methods for obtaining majority ownership are becoming increasingly common: investing in *maquiladoras*, buying out Mexican partners, and Section 511 swaps.

The* Maquiladora *Program. *Maquiladoras*—also known as in-bond plants—represent 51 of the 70 cases where foreigners gained majority ownership in 1984. 25X1 The government created the *maquiladora* program in 1966 to boost employment along the US-Mexican border, but the program did not become popular until the 1980s. Enthusiasm for the *maquiladora* program stems from internationally competitive labor costs, which are primarily the result of the peso's dramatic devaluation. According to press reports, direct labor savings per employee in the *maquiladoras* total $15,000 to $20,000 annually over US labor, and, as a result, 52 percent of the total value added in *maquiladoras* is directly attributable to labor. 25X1

Besides relatively low-cost Mexican labor, a number of special exemptions are given to *maquiladora* investors:

- *Maquiladoras* are not required to have 51-percent Mexican ownership as stipulated in the 1973 Law.
- Capital equipment, components, and raw materials for the operation are allowed duty-free entrance. 25X1
- Foreign management and technical personnel may be issued unlimited business visas.

Most *maquiladoras* utilize the US tariff schedule, which stipulates in items 806.3 and 807 that US-made components assembled abroad will be subject to US duty only on the value added, upon reentry. 25X1

Maquiladoras are typically required to export all of their output. 25X1 According to press reports, less than 4 percent of all *maquiladoras* have won government permission to sell some of their product in the domestic market. As Mexican corporations, *maquiladoras* are also subject to all corporate taxes and labor laws. Although the value-added tax applies, it is paid at a lower rate and is refundable. Detailed operation reports must be submitted to the Bank of Mexico each month. A deposit equal to one month's operating expenses must be placed with a Mexican bank. *Maquiladoras* must also post bonds equal to 40 percent of the value of components and raw materials and 60 percent of capital equipment. 25X1

Buying Out Mexican Partners. Although the export-oriented *maquiladoras* represent the bulk of new 25X1 majority-foreign-owned companies, some foreigners

Table 1
Selected LDC Debtors: Summary of Foreign Investment Regulations

Country [a]	Entry	Ownership	Remittances
Argentina (2.1)	Prior approval by the National Executive is required for, inter alia, investments in most public utilities, communications, energy, and in financial and insurance institutions; as well as for all investments exceeding $20 million.	Prior approval by the National Executive is required for investments that involve changing the national ownership structure of a local firm with net assets exceeding $10 million. No prior approval is required for new investments that do not exceed 30 percent of the registered capital of the receiving firm.	Annual aftertax profits on registered foreign capital are subject to an additional, progressive tax when they exceed 12 percent of registered capital. In times of severe foreign exchange constraints, profit transfers can be suspended and foreign investors will receive the equivalent sum in external public debt securities. Registered foreign investments may be repatriated after three years, unlesss a longer period was fixed when the investment was approved.
Brazil (2.3)	Foreign investment in certain sectors (for example, mining and computers) is restricted. Inward transfers are generally unrestricted but, together with any reinvested profits, must be registered to assure repatriation of capital and profits. Oil exploration is controlled by the state petroleum monopoly.	Prior approval is required and some sectors require majority local ownership.	No limit on dividend remittances, but net remittances above 12 percent of total registered capital are subject to supplementary taxes of 40 to 60 percent. Profit remittances are subject to a 25-percent withholding tax. Remittances of royalties by a branch or subsidiary to its head office are not allowed when 50 percent or more of the local firm's voting capital is held by its foreign parent company. Capital repatriation is subject to a capital gains tax. In all cases, the government reserves the right to suspend remittances and repatriation.
Korea (0.2)	A list of activities and projects closed to foreign investment is maintained by the Ministry of Finance; however, 80 percent of all industries are open to foreign investment.	Prior approval is required for all investments, unless foreign ownership is less than 50 percent and the capital invested is less than $1 million.	No legal restrictions, according to US Embassy.
Mexico (2.2)	New foreign direct investment in Mexican banking, insurance companies, and investment funds is prohibited. Certain sectors (including radio and television, public transportation, and forestry) are reserved exclusively for Mexicans. Other sectors (including petroleum, basic petrochemicals, electricity and nuclear energy, railroads, and telecommunications) are reserved for government investment. All foreign direct investment must be registered.	Foreign acquisition of more than 25 percent of the capital of a Mexican company requires prior authorization by the National Foreign Investment Commission. All new investments must have a majority participation of Mexican capital, except for cases specifically approved by the Foreign Investment Commission.	Profits and dividends are freely remittable, subject to foreign exchange availability, and provided a company is registered, meets legal reserve requirements, and meets tax obligations.

Table 1 (continued)

Country [a]	Entry	Ownership	Remittances
Philippines (0.8)	All investment is subject to the prior approval of the Central Bank. Preference is given to projects approved by the Board of Investments (BOI), to export-oriented industries, and to other industries not utilizing domestic credit resources.	New enterprises where investment by non-Filipinos exceeds 30 percent, and that are not covered by the Investment Incentives Act, require prior approval by the BOI. If purchases of shares by foreign nationals would reduce Philippine ownership in a firm to less than 70 percent, permission from BOI is required. There are different arrangements for "pioneer" and "preferred" investments. Normally, enterprises owned or controlled by foreigners are allowed only in "pioneer areas of investment," and at least 60 percent of outstanding voting capital stock of enterprises in "preferred areas of investment" must be owned by the Filipinos.	Profit remittances are permitted in full, provided they are not financed from domestic borrowing. Full repatriation is guaranteed by law for cash investments made after March 1973 in export-oriented industries and for enterprises approved by the BOI. Noncash investments and cash investments made before March 1973 can be repatriated in a number of annual installments, according to the category of the investment and its net foreign exchange earnings.

[a] Indicates net foreign direct investment expressed as a percentage of gross fixed investment for 1976-85.
Source: Chase Econometrics and the International Monetary Fund.

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have been able to increase their participation in companies where they formerly held minority control by getting government authorization to buy out their Mexican partners. [redacted] the government approved a plan in July 1985 for a foreign electronics firm to buy out its Mexican partner. The company had been under increasing pressure from the government to increase exports, but the Mexican partner had been unable to provide any capital for improvements or expansion. In fact, the Mexican partner originally borrowed from the foreign firm to purchase 51 percent of the company's stock. Because the Mexican partner had very little equity and was limiting the company's export potential, the government allowed the foreign firm to assume full ownership. [redacted] 25X1

Officials also approved the reorganization of a Mexican chemical company to 85-percent foreign equity and control. The foreign partner agreed to buy out the Mexican investors because they were unwilling to infuse additional capital to modernize the plant [redacted] the foreign company had concluded similar negotiations for 100-percent ownership and control of two other chemical plants earlier in 1985. [redacted]

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Section 511 Swaps. Debt-equity swaps also represent a new method for obtaining majority foreign ownership in Mexican companies. The Mexican Secretariat of Finance (SHCP) is reviewing an increasing number of proposals from foreign banks and investors interested in converting discounted Mexican foreign-held debt into foreign investment in Mexico. According to US Embassy reporting, the Mexican Government is developing a system to expedite these transactions, which are often referred to as Section 511 swaps because that part of the debt restructuring agreement provides their authorization. [redacted]

According to the US Embassy, one very recent example of a Section 511 swap was completed by the US chemical company, Rohm and Haas. The company negotiated the purchase of a Matamoras plastics manufacturing company for $1.5 million. Rohm and Haas purchased $1.5 million of Mexico's public-sector debt for 65 cents on the dollar from a commercial bank. In turn, they sold the debt to the Mexican Government, at the controlled rate, for 100 cents on the dollar to obtain pesos. The plastics company ended up costing Rohm and Haas about $1 million plus fees. [redacted]

[redacted] the SHCP already approved three other investment projects utilizing discounted Mexican public-sector debt: a $40 million investment by Nissan of Japan, a $17 million investment by Club Med of France, and a $5 million investment by a US consumer products company already in Mexico. Another project reported to be nearing approval involves Dina-Komatsu, a joint venture between a state-owned company and a Japanese firm. Approval would convert the venture to Japanese equity control. [redacted]

Even though investors have redeemed Mexican debt obligations for less than 100 cents on the dollar, swaps have generally worked well so far. Nevertheless, they could result in two very serious problems. First, if Mexico prints pesos to give investors, inflation would accelerate. Second, if a big market develops with commercial banks selling discounted debt to foreign investors, foreign bank regulators may force the banks to write down the value of their remaining Mexican loans. [redacted]

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Impact on Foreign Investment

While some foreign investors are finding ways to gain majority control over their assets, the influence of foreign investment in the Mexican economy remains limited. Fidel Velazquez—head of the powerful Mexican Confederation of Workers—asserts that Mexico would lose its character as an independent and sovereign nation if the foreign investment laws were changed, but Under Secretary Hegewisch stated that foreign investment represents only 2.5 percent of total investment in Mexico, or about 4.5 percent of total private-sector investment. [redacted] [redacted] net foreign direct investments have averaged only 2.2 percent of annual gross fixed investments during the last decade (see table 1). Even at its peak in 1982, foreign investment represented only 4.7 percent of total investment (see figure 1). [redacted]

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[redacted] total authorized foreign direct investment in 1985 amounted to a single-year record of $1.8 billion. These statistics are compiled by the Directorate General of Foreign Investment and are the numbers most frequently quoted by Mexican officials. The number is based on the total value of projects approved by the FIC plus new foreign investment that is entered in the National Registry for foreign investment without the need for approval. The statistics do not reflect current actual investment because the authorized projects may occur over a period of years, or they may never materialize. The actual capital flow resulting from foreign investment is calculated by the Bank of Mexico. The two measures are quite different concepts. In fact, the flow as measured by the Bank of Mexico has been declining as a percentage of authorized investment as measured by the Directorate General in each of the last three years. The flow represented 67.1 percent of authorized foreign investment in 1983, 27.1 percent in 1984, and 26.5 percent in 1985. [redacted]

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Figure 1
Mexican Investment by Type, 1975-85

Billion 1985 US $

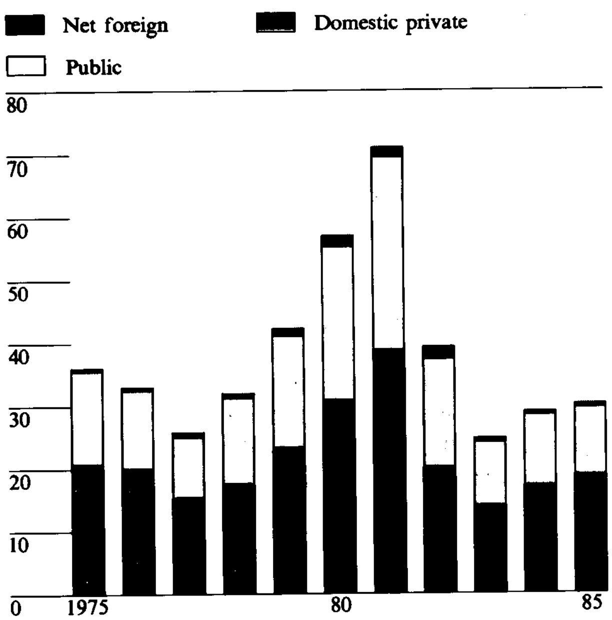

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Table 2
Cumulative Number of Mexican Firms With Foreign Capital Participation, 1981-85

	Total Number of Firms	Foreign Participation			
		Up to 49 Percent		Above 49 Percent	
		Number of Firms	Share of Total	Number of Firms [a]	Share of Total [a]
1981	5,731	3,081	53.8	2,650	46.2
1982	6,129	3,451	56.3	2,678	43.7
1983	6,390	3,680	57.6	2,710	42.4
1984	6,684	3,904	58.4	2,780	41.6
1985	6,964	4,114	59.1	2,850	40.9

[a] Includes new *maquiladores* (in-bond plants), which typically are restricted from selling to the domestic market.

Source: Directorate General of Foreign Investments.

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Majority Ownership. Despite Mexico's announced receptiveness to 100-percent foreign ownership in specified sectors, the percentage of majority-foreign-owned companies has declined relative to the number of firms with foreign participation throughout the 1980s. The absolute number of majority-foreign-owned companies, however, increased by 70 per year in 1984 and 1985. Most of the increase was due to new *maquiladoras* or existing operations where foreign participation increased from a minority to a majority position (see table 2).

Maquiladoras accounted for more than 70 percent of new firms with majority foreign ownership in 1984. there are 800 *maquiladora* plants, representing more than one-fourth of all majority-foreign-owned firms. The US Embassy estimates that 68 percent of the *maquiladoras* are either wholly or majority US owned. There are also Japanese, British, Hong Kong, South Korean, Finnish, Spanish, French, Dutch, and Mexican *maquiladoras*. 25X1

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The Investor Countries. Despite a stated policy of the Mexican Government to achieve a greater balance among foreign investment sources, the United States accounts for more than two-thirds of cumulative authorized foreign direct investment, according to US Embassy reporting. For 1985 the US share of total authorized foreign direct investment jumped to 83.5 percent. Although less than one-third of cumulative authorizations for direct investment has gone to Western Europe and Japan, Mexico has particularly targeted these areas to provide greater diversification in its sources of foreign investment (see figure 2). 25X1

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Where more complete data are available, as in 1984, it is interesting to note that Mexico rejected more than 60 percent of the combined value of new direct investment proposed by West Germany and Japan 25X1

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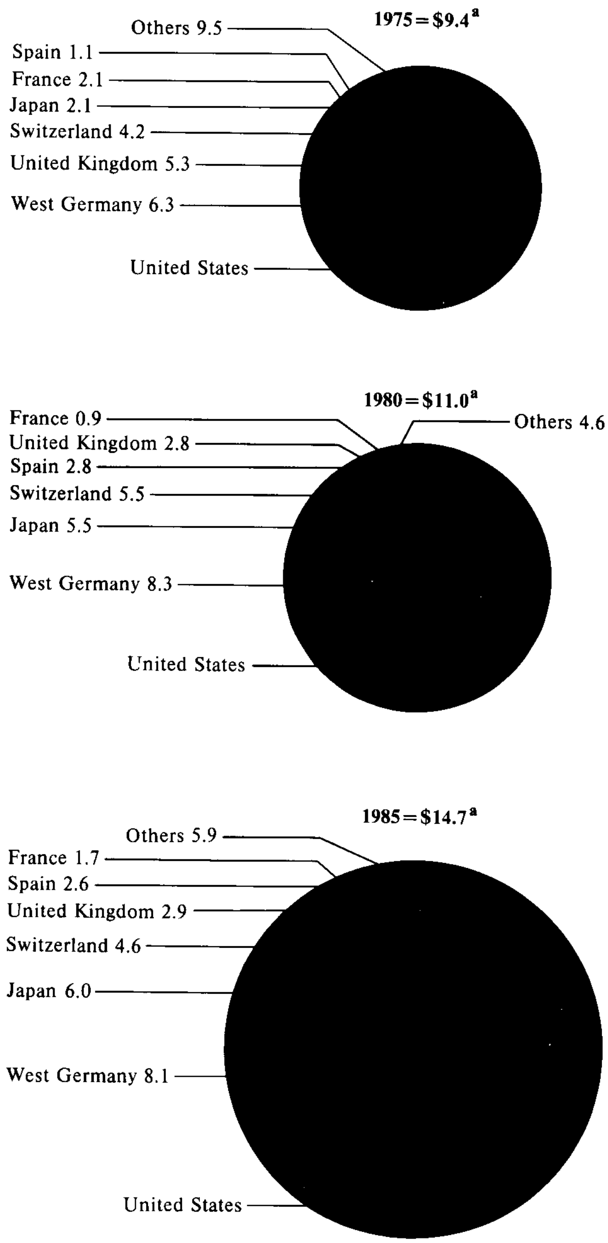
Figure 2
Cumulative Authorized Foreign Investment in Mexico, 1975-85

Percent



[a]Billion 1985 US $.

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(see table 3). 25X1

Hotels and *maquiladoras* that are subsidiaries of foreign companies are paid for their services by the foreign company, which generally collects receivables and retains profits outside Mexico. 25X1

In most cases, direct foreign investment in 1985 came from the same countries that have traditionally invested in Mexico. The largest non-US authorizations in 1985 came from West Germany, with 4 percent; Japan, with 3.9 percent; and Switzerland, with 1.8 percent. According to the US Embassy, the most important West German investments in Mexico belong to Volkswagen, Hoechst, Bayer, BASF, and Siemens. The principal Japanese investors are Nissan and Komatsu. Leading Swiss investors are Nestle, Ciba-Geigy, and Sandoz. Other noteworthy investments are by ICI of the United Kingdom, Renault of France, Ericcson and SKF of Sweden, Olivetti of Italy, and Aurrera of Spain. 25X1

Over two-thirds of all investments made by non-US sources in Mexico during 1984 resulted from foreigners increasing their capital stock in existing firms, according to US Embassy reporting. Although this increase resulted in higher total investment, it does not necessarily reflect increased optimism by foreigners doing business in Mexico. With foreign exchange difficult to obtain, companies may have decided to place earnings, which might have otherwise been repatriated, back into their operations. The alternatives include depositing the funds in Mexico's nationalized banking system at what have often been negative real interest rates. 25X1

Industrial Composition. Manufacturing industries have accumulated about 78 percent of all foreign investment in Mexico and 95 percent of all investment

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Table 3
Proposals and Approvals for New Direct Foreign Investment in Mexico, 1984

Million US $

	Proposed	Approved	Approved as a Share of Proposed Amount *(percent)*	Denied	Pending
Total	**1,185.8**	**913.1**	**77.0**	**79.0**	**193.7**
United States	971.2	747.3	76.9	35.8	188.2
Liechtenstein	31.3	31.3	100.0	0	0
West Germany	30.8	10.6	34.4	20.2	0
Canada	25.0	17.8	71.2	7.0	0.1
United Kingdom	23.7	23.7	100.0	0	0
Sweden	22.7	22.2	97.6	0	0.5
The Netherlands and Belgium	17.2	11.7	67.9	4.0	1.6
Switzerland	17.0	16.9	99.5	0.1	0
Panama	16.0	13.7	86.0	2.2	0
Japan	7.9	4.3	54.2	3.6	0
Spain	6.0	5.6	93.1	0.4	0
France	5.7	4.2	73.7	0	1.5
Denmark	4.6	0.5	10.3	4.1	0
Others	6.6	3.3	50.7	1.5	1.8

Note: Approved investment does not represent the actual inflow of foreign direct investment during a year. The flow as reported by the Bank of Mexico was only $391 million in 1984. Proposed may not equal the sum of approved, denied, and pending due to rounding.

Source: National Commission for Foreign Investment.

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authorized in 1984, according to US Embassy reporting. A more detailed breakdown shows that the areas of greatest investment are also the areas regulated by the automotive, pharmaceutical, and personal computer decree. Foreign participation is particularly important in the following segments of Mexican manufacturing: all aspects of ground transportation equipment and components; mainframe and personal computers; chemicals; pharmaceuticals; office equipment; soups, sauces, bottled foods, and vegetable freezing within food processing; electrical assemblies and equipment; household appliances; cement; and aluminum (see table 4).

The service industries represent the second-highest area of accumulated foreign investment in Mexico, with about 12 percent of the total. Within the service industries, foreign investment is highly concentrated in the lodging and technical consulting fields. The commercial sector represents about 8 percent of cumulative foreign investments. Mining industries still maintain almost 2 percent of total foreign investment even though discriminatory tax methods have been used by the Mexican Government to remove foreign influence. In agricultural industries, foreign investment is very small because of deep-seated and widespread lack of confidence in land tenure, according to the US Embassy.

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Table 4
Mexican Approvals for New Direct Foreign Investment by Economic Activity, 1984

Million US $

Activity	Approved Subtotals	Share of Total *(percent)*	Approved Totals	Share of Total *(percent)*
Total			**913.1**	**100.0**
Manufacturing			867.6	95.0
Transport equipment	617.0	67.6		
Electric products	76.5	8.4		
Machinery and equipment	56.7	6.2		
Chemical	29.6	3.2		
Food processing	29.3	3.2		
Other	58.5	6.4		
Service			42.6	4.7
Commerce			2.3	0.2
Agriculture			0.7	0.1
Mining			0	0

Note: Approved investment does not represent the actual inflow of foreign direct investment during a year. The flow as reported by the Bank of Mexico was only $391 million in 1984.

Source: Directorate General of Foreign Investments.

Geographical Dispersion. Nearly 80 percent of all foreign direct investment is located in the Federal District and the surrounding State of Mexico, according to US Embassy reporting (see figure 3). The concentration of both domestic and foreign firms around the capital city is of major concern for the Mexican Government. Although business is attracted by the highly developed infrastructure and the proximity to the federal government in Mexico City, a population of about 18 million is straining social services, and pollution from the concentration of industry and vehicles is creating a health hazard. The relocation of businesses and government offices is an announced government policy. The government is offering large tax incentives, mostly to majority-Mexican-owned firms, to relocate. Majority-foreign-owned firms in Mexico City's metropolitan area, on the other hand, are finding their operations increasingly restricted by the FIC's refusal to grant expansions and new product lines. 25X1

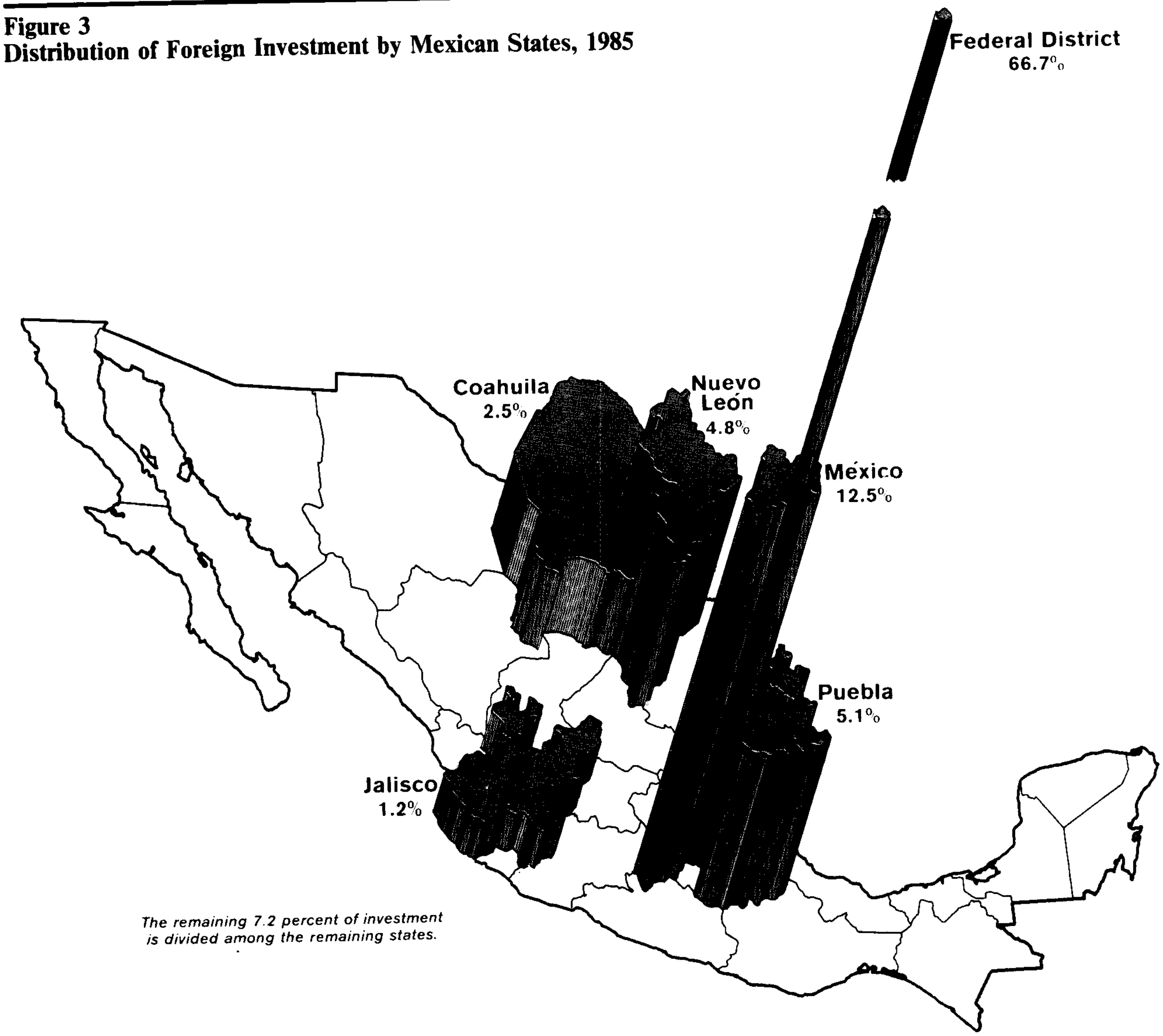
Besides the Federal District and Mexico, only four other states have accumulated more than 1 percent of the country's foreign direct investment, according to the Directorate General for Foreign Investment in Mexico. The nonborder States of Puebla and Jalisco have significant levels of foreign investment that surround the large cities of Puebla and Guadalajara, respectively. While all of the US border states have pockets of foreign investment as a result of the *maquiladora* program, the most notable concentrations are in the States of Nuevo Leon and Coahuila. 25X1

Prospects for Change

Although foreign investors see many opportunities in Mexico including a large domestic market, low labor rates, and proximity to the US market, we believe it is highly unlikely that new foreign direct investment will play a major role in Mexico's economic recovery. The PRI has firmly implemented policies to restrict foreign participation in the economy under its longstanding philosophy of state-led economic growth. Even in the peak year of 1982, net foreign direct investment represented only a small fraction of gross fixed investment. Beyond restrictive policy, the severity of Mexico's economic decline is a major deterrent to potential investors. 25X1 25X1

While de la Madrid views foreign investment more favorably than his recent predecessors, he has not been able to bring about any major structural change. Press reports indicate the established business community, government bureaucrats, labor leaders, and leftist ideologues—all well served under the present system—have blocked structural reforms necessary to attract foreign investment, promote development, and spur economic growth. As a result, we expect most new foreign investment will be in the form of capital stock increases to buoy existing Mexican investments. Some new investments might be made by large MNCs that wield significant political clout and have extensive financial resources, but we anticipate few

Figure 3
Distribution of Foreign Investment by Mexican States, 1985



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other companies will brave the uncertainties of investing in Mexico over the next few years. Under these conditions, we estimate foreign investment inflows will average about $500 million annually through 1990.

On the other hand, we believe the debt issue could spark a new wave of radical nationalism with potentially disastrous results for foreign investment. If the Mexicans perceive that their creditors are taking an uncompromising position and Mexico City repudiates all or part of the external debt, we would expect inflows of foreign investment to grind nearly to a halt. A temporary suspension in payments, however, would probably leave foreign investors relatively indifferent.

In a less likely scenario where Mexico implemented significant reforms, we still would not expect a dramatic increase in foreign investment. Most potential investors probably would wait and see if Mexico City were committed to lasting change. Foreign direct investment is typically a long-term phenomenon, often requiring more than a decade just to recover costs. Private investors who suspect that liberalizations in policy represent a quick fix to deal with the current economic malaise probably would not change their investment decisions.

Should Mexico City take sufficient steps, foreign direct investment could make an important contribution to Mexico's long-term economic development. In our view, the major contribution would not be financial, however, as even a doubling of last year's direct investment inflow would represent only a small fraction of the foreign borrowing expected this year. Instead, we believe the principal benefits of increased foreign investment arise from transfers of technology and the management practices introduced. Furthermore, multinational corporations establishing subsidiaries in Mexico would allow Mexican enterprises to form valuable customer and supplier linkages with foreign firms.

At the margin, there are some improvements that the Mexican Government might make to improve the investment climate. If Mexico were to continue to reduce and simplify the number of forms and procedures that foreigners had to complete for initial approval and normal operations, they would reduce the cost to both the foreign investor and the Mexican taxpayer. The government could also eliminate remaining import permit requirements. Even if they were replaced with high tariffs, this would remove some of the government's discretionary control over business transactions. By applying tax legislation and fiscal incentives equitably to all firms at levels that currently apply to foreigners, the government would be able to preserve if not increase its revenue.

Structural changes would be harder to implement because of vested interests, but, in our judgment, they would certainly make Mexico more attractive to foreign investors in the long run. Price controls could gradually be lifted by moving products through the various categories of control until they were market determined, with the results being reduced shortages and more efficient resource allocation. A detailed timetable could be established whereby all nonstrategic state enterprises would be sold or closed, leading to smaller public-sector deficits. Protection for intellectual property—including products, processes, and trademarks—could be strengthened, which would provide greater incentive for research and development. The obsession with preventing foreign majority control might be dispensed with in a revision of the 1973 Law that specifies those sectors where majority-foreign-owned companies would be absolutely prohibited, allowing unrestricted foreign access to all other sectors.

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1973 Foreign Investment Law

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Appendix A[1]

The 1973 Foreign Investment Law

The stated purpose of Mexico's Foreign Investment Law of 1973 (1973 Law) is to "promote Mexican investment and regulate foreign investment in order to stimulate a just and balanced development and consolidate the country's economic independence." The 1973 Law centralizes controls over foreign investment within the National Commission on Foreign Investment. It states that foreign investment "will be received when it helps to achieve the country's objectives and when it acts to complement national investments and does not displace existing business enterprises that operate satisfactorily." 25X1

Investment Categories

Economic activity is divided into four major categories. The first is reserved exclusively for the state and includes petroleum and basic petrochemicals, nuclear energy, most areas of mining, electricity, railroads, telegraphic and wireless communications, and certain other areas as specified by law. The second category is reserved exclusively for Mexicans with an exclusion-of-foreigners clause. This includes radio and television, automotive and federal highways transportation, domestic air and maritime transportation, forestry resources, gas distribution, and certain other areas. The third category specifies areas in which foreign participation is limited to less than 49 percent. Foreign participation is limited to 34 percent for concessions in national mining reserves and to 40 percent for secondary petrochemical operations and for automotive parts manufacturing. The other areas fall under the fourth category, which allows foreign ownership of up to 49 percent as long as the foreign interest is not empowered to determine the management of the business. The Government of Mexico can flexibly administer the 1973 Law and has authorized 100-percent majority-foreign-owned ventures, although these are the exceptions rather than the rule. 25X1

The National Commission on Foreign Investment (FIC) was established under the 1973 Law. The FIC is formed by the Secretaries of Interior; Foreign Affairs; Treasury; Energy, Mines and Parastatal Industry; Commerce and Industrial Development; Labor and Social Security; and Planning and Budget. Beyond its central function of administering the Foreign Investment Law, the FIC serves as the decision-making body regarding all foreign investment questions not already covered by law. It decides on increases or decreases in foreign percentage ownership allowances in Mexican enterprises—foreigners are allowed to maintain the original proportion between Mexican and US capital but may not increase the percentage of foreign capital without the permission of the FIC—and it must approve any foreign investment in Mexican companies beyond 25 percent of capital or 49 percent of assets. FIC permission must be sought for majority-foreign-owned investment in Mexico, and, as a general rule, the Commission's permission must also be sought for expansions in existing operations. 25X1

In screening applications to invest in Mexico, the Commission uses 17 criteria stated in Article 13 of the law. In rather general terms, these criteria try to ensure that the proposed investment will have a beneficial effect on Mexico in the following areas: balance of payments, employment, wage and price scales, technology transfer, regional development, total national investment, and national economic policy. Permission to make an investment is often granted subject to meeting additional performance requirements that are negotiated on a case-by-case basis. 25X1

The National Registry of Foreign Investment was created pursuant to Article 23 of the 1973 Law. It requires that all foreign investors, Mexican companies with foreign investment, trusts with foreign participation whose purpose is regulated by the 1973 Law,

[1] This appendix draws entirely on materials from "Investing in Mexico," *Overseas Business Reports*, US Department of Commerce, International Trade Administration, December 1985. 25X1

foreign-held shares, and FIC resolutions be registered with this entity. Currently, the National Foreign Investment Registry is located within the Secretariat of Commerce and Industrial Development. Penalties for noncompliance with the above-mentioned requirements are stiff. Companies that fail to register may not pay dividends, and acquisitions that are not registered are considered void. Offenders face expensive fines and imprisonment.

Special Provisions

The law contains certain special provisions of particular interest. The first of these, known as the Calvo Clause with its origins in Article 27 of Mexico's 1917 Constitution, requires foreigners who acquire properties of any kind in Mexico to agree "to consider themselves as Mexican nationals with regard to these properties and not to invoke the protection of their government, with respect to such properties, under penalty, in case of violation, of forfeiting to the Nation the properties thus acquired."

In addition, foreign entities are forbidden to hold title for land within 100 kilometers of Mexico's borders or 50 kilometers of the coast. Foreigners may, however, obtain permission to use restricted lands for tourism or industrial purposes through "participation certificates." These are held by Mexican fiduciaries who hold title to the land in question. Foreigners must also obtain permission from the Secretariat of Foreign Affairs to acquire real property outside the forbidden zone. 25X1

Modifications and clarifications of the 1973 Law are handled by the FIC, which issues occasional resolutions. Several resolutions have been designed to deal with the confusion surrounding the expansion of existing businesses and permission to enter new ventures. The most important, Resolution 16, issued in September 1977, states that, prior to investing in a new field of economic activity or a new line of products, established corporations must seek the approval of the FIC and the ministry with jurisdiction over the activity. Resolution 16 defines "new field of economic activity" and "new line of products" in broad terms. 25X1

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Often permission to make an investment is granted subject to a company's commitment to adhere to certain performance criteria such as those establishing minimum export and local-content levels. Specific requirements are established for the enterprise in order to ensure attainment of objectives set forth in the Foreign Investment Law. These are not made public and are negotiated on a case-by-case basis.

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Transfer of
Technology Law

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Appendix B [2]

The Transfer of Technology Law

In an attempt to promote the development of indigenous technology, Mexico promulgated the "Law on the Registration of the Transfer of Technology and the Use and Exploitation of Patents and Trademarks" in 1973. It required the registration of all contracts involving the transfer of technology. The law specified the conditions to be met in order to receive registration and stated 14 reasons for automatic denial. 25X1

Registration Requirement
In 1982, the law was replaced by the "Law on the Control and Registration of the Transfer of Technology and the Use and Exploitation of Patents and Trademarks." The revised law gives the government increased jurisdiction in this area and expands the number of agreements requiring registration. Failure to register renders an agreement null and void, unenforceable in the courts, and ineligible for government development support. Furthermore, failure to register a technology agreement is subject to a fine of up to the amount of the transaction or 10,000 times the daily minimum wage in Mexico City. 25X1

The administrative apparatus for this law is the National Registry of the Transfer of Technology. The law and the registry are administered by the Secretariat of Commerce and Industrial Development. 25X1

The registry carefully scrutinizes contracts based on a number of criteria including costs and the local availability of the technology in question. It will try to negotiate contracts under the law so as to maximize local management. In enacting this law, the Mexican authorities sought to reduce dependence on foreign technology and to provide state support to Mexican purchasers in their negotiations with the foreign companies. In effect, the law reinforces FIC restrictions on foreign control of Mexican enterprises. The following are the agreements, contracts, and other acts that must be registered with the National Registry of the Transfer of Technology:

- Concession of use or authorization to exploit works; patents of inventions or of improvements and certificates of inventions.
- Assignment of trademarks and patents.
- Concession of authorization to use commercial names.
- Transmission of technical knowledge through plans, diagrams, models, instruction manuals, formulas, specifications, education and training of personnel, and other means.
- Technical assistance in any form it is rendered.
- Provision of basic or detailed engineering.
- Services of operation or administration of enterprises.
- Counseling, consulting, and supervising services.
- Concession of copyrights that imply industrial exploitation.
- Computer programs, that is, the transactions for transfer of software, not the details of the programs themselves. 25X1

The following are exempt from registration requirements:

- Foreign technicians coming to Mexico for the installation of factories or machinery or to make repairs.
- Provision of designs, catalogues, or counseling in general that are acquired with the machinery or equipment and that are necessary for their installation if and when it does not imply the obligation to make subsequent payments.
- Assistance in repairs or emergencies if and when they derive from some act, agreement, or contract that has been previously registered. 25X1

[2] This appendix draws entirely on materials from "Investing in Mexico," *Overseas Business Reports*, US Department of Commerce, International Trade Administration, December 1985. 25X1

- Teaching or technical training furnished by educational institutions, by personnel training centers, or by companies to their workers.

- Industrial exploitation of copyrights relating to the publishing, motion picture, recording, radio, and television industries.

- International agreements for technical cooperation executed between governments. [redacted]

Denial of Registration

Certain types of agreements are automatically denied registration. Article 15 of the revised law specifies 17 causes for denial that include: restrictions on improvements in the transferred technology, interference in the management practices of the recipient, requirements to accept supplies from an exclusive source, limitations on the export of the finished product, prohibition of the use of complementary technologies, obligation to sell to one exclusive buyer, directives on personnel use, limitations on volume of production or imposition of sale or resale prices, most obligations to execute exclusive sales or representation contracts with the supplier, obligations to maintain the secrecy of technical information beyond the duration of the agreement, lack of declaration of responsibility by the supplier for infringement of the industrial property rights of third parties, and lack of quality guarantees. [redacted]

Moreover, ordinarily acceptable agreements are denied registration when the technology is already available in Mexico, the fee is considered excessive, the duration of the agreement is considered excessive—no agreement may in any case last more than 10 years, or foreign arbitration is enlisted for resolutions of disputes related to or arising from the agreement—the Calvo Clause. The duration standard and confidentiality standard established in this law raise some of the most difficult questions facing foreign technology providers in determining whether to supply technology to Mexico. In essence, the Technology Transfer Law has been interpreted and applied to permit the acquisition of foreign technology only by the installment purchase method and not by the lease method. [redacted]

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In many of the areas noted above, negotiation is possible with the registry on a case-by-case basis. Exceptions are granted when it is considered in the "best interests of the country." [redacted]

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Previously, the in-bond assembly or *maquiladora* plants had been excluded from registration requirements under the 1973 Technology Transfer Law. Now *maquiladoras* must adhere to the registration requirements of the 1982 Law. [redacted]

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Inventions and
Trademarks Law

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Appendix C [3]

The Law on Inventions and Trademarks

Mexico replaced its 1942 Industrial Property Code in 1976 with the Law on Inventions and Trademarks. The 1976 Law created new categories of nonpatentable items and increased the restrictions on the granting and use of patents and trademarks. The National Registry of the Transfer of Technology was charged with approving contracts concerning patents, trademarks and trade names. According to Article 10 of the law, the following items are not patentable:

- Plant varieties and animal breeds as well as biological processes for obtaining the same.

- Alloys.

- Chemical products, with the exception of new industrial processes for obtaining the same and their new uses of an industrial nature.

- Chemical-pharmaceutical products and their mixtures, medicines, beverages, and foods for human or animal use, fertilizers, pesticides, herbicides, fungicides.

- Processes for obtaining mixtures of chemical products, industrial processes for obtaining alloys, and industrial processes for obtaining, modifying, or applying products and mixtures to which the preceding paragraph refers.

- Inventions pertaining to nuclear energy and security.

- Antipollution apparatus and equipment of the processes for manufacture, modification, or application thereof.

- Juxtaposition of known inventions, their variation of form, of dimensions, or of materials, except when in fact there is a combination or fusion of these inventions involved in such a manner that they cannot function separately or that the characteristic properties or functions of the same are modified so as to obtain a novel industrial result.

- Application or use in an industry of an invention already known or utilized in another industry and processes that consist simply of the application or use of a device, machine, or apparatus which operates in accordance with previously known principles, even though such application is new.

- Inventions the publication or exploitation of which is contrary to the law, to public order, to health, to public security, to morals, or to good customs. [redacted] 25X1

Inventions referred to in the fifth, sixth, and seventh items above may be protected through registration and the issuance of a certificate of invention. The certificate of invention does not provide the right of exclusive use to the inventor. Instead, the certificate guarantees to the inventor the right to collect royalties from any party that wishes to use the invention. A certificate of invention is available as an alternative to a patent for any patentable invention as well as for certain types of nonpatentable inventions as noted above. The certificates have a duration of 10 years. [redacted] 25X1

Patents also have a duration of 10 years and may not be extended. Article 40 provides that patents must be used within three years from the date of issuance. Otherwise, during the fourth year, the Secretariat of Commerce and Industrial Development may authorize an obligatory nonexclusive license to use the patent. Mexican authorities must approve the amount of royalties to be paid and other terms for such a

[3] This appendix draws entirely on materials from "Investing in Mexico," *Overseas Business Reports*, US Department of Commerce, International Trade Administration, December 1985. [redacted] 25X1

license. If a valid request for a compulsory license is not made during the fourth year, the patent will expire. 25X1

The duration of trademarks was reduced from 10 to five years by the 1976 Law. The law allows for registration renewal for successive five-year periods but only if the trademark is effective and uninterrupted use during the preceding five-year period is proved. The most troubling aspect of the law regarding trademarks for foreign firms is the one that requires all products produced in Mexico to carry a distinctive Mexican trademark, equally linked to the foreign or international mark and owned by the Mexican entity. This provision produced so much controversy that it has been suspended annually and has yet to be implemented. It may, however, be invoked at any time either in its entirety or on a selective basis. 25X1

Potential for
100% Ownership

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Appendix D [4]

Potential for 100-Percent Ownership

In February 1984, the FIC published a press release signed by several Mexican Government secretaries that explained foreign investment policy and the reasons for the promotion of foreign investment. It emphasized that foreign investment would be complementary to domestic investment and contribute positively to the development objectives without displacing national investments. The Mexican Government said that it intended to promote foreign investment, with the possibility of 100-percent foreign ownership, in selected sectors with a view toward stimulating activities that generate net foreign exchange inflows and contribute to national technological development. The Mexican authorities also said they would favorably consider complex industries that otherwise could not be developed in Mexico—industries requiring large investments per employee, industries with high export potential, and in-bond industries. 25X1

Following is a list of high-priority industries for foreign investment published by the Government of Mexico:

- *Machinery and Nonelectric Equipment*
  Agricultural machinery and implements
  Woodworking machinery
  Food processing and packaging machinery
  Machinery for petroleum and petrochemical industries
  Textile machinery
  Extruding and molding machinery for the plastics industry
  Machinery for the graphic arts industry
  Cranes, pulleys, and similar equipment

- *Machinery and Electric Apparatus*
  High-power motors and generators
  Turbines for industry
  High-power turbocompressors

- *Metal-Mechanics*
  High-technology metallurgy
  High-precision instruments for microsmelting
  Specialized equipment

- *Electronic Equipment and Accessories*
  Telecommunications equipment
  Magnetic tapes and disks for computers
  Computer systems, parts, and components
  Instrumentation and process control equipment
  Electronic components, parts, and elements
  Electronic equipment and apparatus for engineering and science
  Consumer electronics

- *Transportation Equipment*
  Motorcycles and similar vehicles with over 350-cc engine displacement
  Internal combustion engines for vessels and locomotives
  Ship construction and repair

- *Chemical Industry*
  Raw materials and active pharmaceutical substances
  Synthetic resins and plastics
  Chemical specialties

- *Other Manufacturing Industries*
  Precision measuring apparatus
  Medical equipment and instruments
  Photographic material and equipment
  New high-technology materials

- *High-Technology Services*
  Biotechnology

- *Hotel Industry*
  Construction and operations related to real property for the hotel industry 25X1

[4] This appendix draws entirely on materials from "Investing in Mexico," *Overseas Business Reports*, US Department of Commerce, International Trade Administration, December 1985. 25X1

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Price Controls

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Appendix E[5]

Products Subject to Price Controls

List I: Products for which prices are frozen:

Foodstuffs: edible vegetable oils; purified, bottled water; processed baby food; rice; canned tuna; oatmeal; sugar; coffee; beef; ham; powdered chocolate; beans; packed fruits and vegetables; crackers; corn flour; wheat and wheat flour; eggs; pasteurized, powdered, condensed, and evaporated milk; corn, cornmeal for tortillas and corn tortillas; bread; pasta; fish; soft drinks; salt; packed sardines.

Products of important domestic industries: medicines of all types.

List II: Products for which companies may petition for price hikes:

Essential raw materials: primary petrochemical products—acetaldehyde; hydrocyanic acid, acrilonitryle, anhydrous ammonium, carbonic anhydride, butadiene, vinyl chloride, dodecylbenzene, styrene, isopropanol, methanol, ethylene oxide, polyethylene; and primary chemical products—hydrochloric acid, hydrofluoric acid, phosphoric acid, denatured alcohol; ethyl alcohol, phosphorus, caustic soda, sodium tripolyphosphate.

Basic industrial products: fertilizers—compound, ammonium phosphate, ammonium nitrate, simple and triple superphosphate, urea; insecticides; fungicides; fuel oil; diesel fuel; liquefied gas; natural gas; gasoline; kerosene; turbosine and other fuels derived from petroleum and natural gas; steel industry products—special steel, wire and wire rope, arrabic, steel bars, iron alloys, tinplate, galvanized and ordinary sheet, mesh, bars, light and heavy shapes, plate, screen, pipe, seamless pipe and construction rods; cellulose; asbestos products; animal feed; fishmeal.

Products of important domestic industries: ampules; domestic appliances—home water heaters, gas and kerosene stoves, washing machines, blenders, sewing machines, electric boilers, radios, refrigerators, irons, and black and white television sets; bicycles; ballpoint pens; bottles and jars; notebooks; paper products; detergents; light bulbs; laundry soap; bath soap; pencils; toothpaste; batteries; automotive products; buses; automobiles; trucks; agricultural tractors; truck tractors; basic pharmaceutical products; packaging for general consumption foodstuffs.

Other products: agricultural machinery and accessories; machines for making tortillas and parts; cornmeal mills and parts.

List III: Products for which prices must be registered:

Foodstuffs: prepared cereals from corn, rice, and wheat; cream; prepared beans; powdered gelatin; fruit juices; butter; margarine.

Clothing: blouses; brassieres; socks; shoes; underwear; shirts; jackets; skirts; panties; trousers; cotton T-shirts.

Essential raw materials: basic chemical products; citric acid; sodium benzoate; chlorine; industrial salt.

Basic industrial products: cement; lime; metals; gypsum.

Products of important domestic industries: toothbrushes; mattresses; tires and tubes; razors and razor blades; plate glass.

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[5] This appendix draws entirely on materials from *Investing, Licensing and Trading,* Business International Corporation, May 1985.

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